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STATEMENT OF  
ELMER B. STAATS, CHAIRMAN, COST ACCOUNTING STANDARDS BOARD  
BEFORE THE  
LEGISLATIVE SUBCOMMITTEE OF THE  
APPROPRIATIONS COMMITTEE  
U.S. HOUSE OF REPRESENTATIVES  
ON  
COST ACCOUNTING STANDARDS BOARD  
BUDGET ESTIMATES FOR FISCAL YEAR 1981

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MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I am appearing before you today in my capacity as Chairman of the Cost Accounting Standards Board to discuss the budget estimates for Board operations during Fiscal Year 1981.

Our budget estimate for Fiscal Year 1981 is \$961,000. This amount is \$339,000 less than was appropriated for Fiscal Year 1980. Before describing the details of our budget estimate, I would like first to review briefly for you the Board's activities to date.

SUMMARY OF MAJOR PROMULGATIONS

The Board has promulgated seventeen Cost Accounting Standards, two interpretations of Standards, and implementing regulations. All of these promulgations are required to be included in major negotiated defense contracts. The major promulgations of the Board are listed in Appendix A to this statement.

The Board also has designed a Disclosure Statement which is used to inform the Government of contractor's cost accounting practices. These Disclosure Statements facilitate the negotiation, audit, and settlement of contracts by requiring major defense contractors to describe cost accounting practices they will follow for negotiated

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defense contracts. The disclosure requirement applies to each contractor who receives in any one year negotiated defense prime and subcontract awards in excess of \$10 million. As of September 30, 1979 the Board has 1667 Disclosure Statements from 288 companies.

#### STANDARDS DEVELOPMENT AND IMPLEMENTATION

The task of issuing sound, fair Cost Accounting Standards is exceedingly complex. To assist the Board in achieving its objectives, the Board seeks the cooperation of all those who have an interest in its work and frequently consults with representatives of all groups, including Government agencies, professional and industry associations, the academic community, and representatives of individual companies. There are more than 1,400 organizations and individuals to whom Board proposals are regularly mailed during the course of the Board's research. These organizations and individuals generally have provided constructive comments on Board materials.

Recognizing that training on Board regulations and Standards could materially assist both industry and Government, the Board has actively participated in training programs of the Government and professional accounting and legal associations. In addition, Board Members and staff speak to interested groups and participate in panels, conferences, and the like which are sponsored by accounting or legal professional associations or by industry associations so that interested parties can obtain information about the Board and its Standards and regulations. The Board pays all travel and living expenses in accordance

with the standardized travel regulations whenever Board and staff members attend out-of-town business meetings.

The Board has also worked cooperatively with Federal agencies in the development of regulations and implementing Cost Accounting Standards and pertinent Board rules and regulations. Reports received by the Board have indicated a number of improvements in contract negotiation and administration because of Board promulgations.

#### CONTRACT COST REDUCTIONS

We have been advised by the Department of Defense that through December 1978 there was a non-recurring net decrease in contract cost of approximately \$230,000,000. In addition they estimated annual recurring cost reductions of \$130,000,000. These are the most recent figures available from the Department of Defense. The estimates were identified with CASB rules and regulations even though some items may have been questioned under ASPR and other requirements in the absence of CAS.

We believe that there may be additional contract cost reductions which cannot be quantified. For example, lower contract prices may have resulted from better cost visibility and reliability due to Standards. This is attributable not only to the fact that negotiations with an individual contractor can be carried out on a more informed basis but to the fact that the use of common cost allocation standards by contractors makes it possible to compare the cost proposals of competing contractors more precisely. The need to continue and enhance

the Government's capacities in these respects is particularly important, in view of the consistent pattern of cost overruns which we have been experiencing and the substantial increase in defense contracting which the President's budget projects.

#### FUTURE ACTIVITIES

When hearings were held concerning the CASB's budget estimates for Fiscal Year 1980, there was an extended discussion of the Board's future. Partly as a direct result of those discussions, the Board has spent a significant amount of time reviewing its activities and considering how it can best fulfill its future responsibilities.

As a consequence of the review that we have made, we have recognized clearly that the nature of the Board's responsibilities is changing. In recognition of this fact we are restructuring the organization. By the beginning of Fiscal Year 1981, the process will be complete. The Board will then be in a position to accomplish its task with a significantly reduced budget. Moreover should Public Law 91-379 be amended to merge the CASB into the General Accounting Office, as I recommended in a hearing held in November of 1979 before the Senate Banking Committee, the new structure will be completely compatible. It will also be adaptable to being merged into any other existing agency.

With substantial completion of the major task assigned to it by Public Law 91-379, the major functions which will continue under the law include the need to assure that defense contractors and Government agencies are implementing promulgated Cost Accounting Standards in the manner intended by the Board. Additionally, there

is the need to review the Cost Accounting Standards to simplify them whenever practical and still achieve the purposes of the law.

The Board's decision to reorient its efforts in this manner is totally consistent with the views of the Deputy Under Secretary of Defense, Dale Church who, by memorandum to Board Member Wacker, recommended a general review of Standards, rules and regulations. In some instances he indicated that further action by the CASB may be effective in reducing contract disputes. In other instances he suggested that revisions might serve to simplify the implementation of Standards and Board rules and regulations.

#### IMPORTANCE OF COST ACCOUNTING STANDARDS TO THE ACQUISITION PROCESS

Since we last appeared before the Appropriations Committee, the future of the CASB has been the subject of hearings held by the Senate Committee on Banking, Housing and Urban Affairs. At those hearings there was testimony by various witnesses on the value of Standards. The testimony served to reaffirm views expressed on several occasions before the Congress during the past five years. In 1975, similar evaluations were expressed by witnesses appearing before the Subcommittee on General Oversight and Renegotiation of the House Banking Committee. There was a widespread opinion among those testifying in favor of termination of the Renegotiation Board that the renegotiation process could be dispensed with because safeguards such as the Cost Accounting Standards were being developed. This view was reiterated in 1978 in the Senate Committee Report (No. 95-717) on the Renegotiation

Abeyance Act of 1978. The report noted "Since the original enactment of renegotiation, Government contracting and procurement procedures have been significantly improved both by regulation and legislation. These improvements, coupled with a vastly improved Government audit capacity, the imposition of cost accounting standards, and the Truth-in-Negotiation Act, do much to create a contracting process with fair and equitable prices and practically preclude the possibility of contractors earning excessive profits."

All of the foregoing emphasize the general recognition of a need for definite groundrules to be used in the negotiation of Government contract costs. Only by having such rules at the time of contracting can both parties negotiate on the basis of the knowledge needed to assure fair and equitable pricing. The basis for obtaining such knowledge has been established in a very large measure by cost accounting standards and the existence of that basis appears to be an important reason for the Congress concluding that renegotiation could be dispensed with safely.

Whether the Senate Committee's interest, or the interest of others in the House or Senate will lead to any revision in the law under which the CASB operates we do not know at this time.

#### CONCLUSIONS

From its inception, the CASB has focused primarily on research in the field of cost accounting and contract cost allocation practices and on development of a coherent set of standards for cost accounting

that would bring uniformity and consistency to the cost accounting practices used for Government contracts. We now have seventeen standards that deal with many cost accounting areas. Appendix B to this statement lists several projects in process which may result in additional Standards. Most of these projects are likely to be completed during the current fiscal year.

Public Law 91-379 provides explicitly that Standards and other issuances of the CASB, when promulgated, "shall have the full force and effect of law." Consequently, in the absence of new legislation the Standards already promulgated by the Board and included in Government contracts would continue to be applicable even if the CASB were to be denied sufficient funds to assure sound administration. As an extreme example, were the Congress to fail to appropriate any funds for the CASB, the Standards would continue to be operative, but there would be no agency with authority to act to modify, amend or authoritatively interpret them. Such a condition would be extremely harmful to the Government as well as contractors. The world of cost accounting is not static. Circumstances change. Special contract situations may require special treatment. It is imperative that there be an agency to act to adjust Standards or to make needed exceptions.

Whenever problems are found the Board will act as appropriate to overcome them. This action is likely to involve development of clarifying interpretations, corrective amendments or new Standards as necessary. Also, when appropriate we expect to be working with

individual contractors and their contracting agencies to determine the proper means of implementing CASB requirement in the context of the facts and circumstances affecting that contractor. Under the proposed redirection the CASB will be fully capable of identifying and responding to these needs with a significantly reduced staff. Personnel reductions have occurred or will occur by the end of the current Fiscal Year. Additional personnel is not being recruited to fill these positions. This reflects our decision to reduce the estimate of the number of permanent positions from 28, which was estimated for Fiscal Year 1980 to 20 for Fiscal Year 1981.

Turning now to our request for appropriations, our budget estimate of \$961,000 for Fiscal Year 1981 will be allocated as follows:

\$757,000 for salaries and related benefits of the members of the Board, permanent professional staff, and supportive clerical staff. This estimate covers the salary costs for 20 permanent positions for Fiscal Year 1981, a reduction of 8 positions from the number estimated for Fiscal Year 1980. The 20 positions include three Board members outside the Government, 12 professional and 5 clerical employees. At the present time we have 25 full-time staff positions filled.

\$46,000 for travel of Board members and staff, which is \$17,000 less than the amount projected for Fiscal Year 1980. This travel

estimate reflects the need to do field work to assure that Standards are operating properly and the continuing need for research and development of possible Cost Accounting Standards or amendments to existing Standards. We must travel to obtain on-site information at contractors' offices and plants regarding cost accounting practices if we are to assure that Standards fulfill their objectives.

\$68,000 for contractual services, computer services and reimbursement to other Government agencies for administrative and personnel services; which is the same as the amount projected for these services in Fiscal Year 1980.

\$90,000 for costs of space and services furnished by GSA, communications, utilities, printing and reproduction, supplies, materials, and equipment, which is a \$13,000 decrease in the amount projected for Fiscal Year 1980.

This statement covers, in general, a summary of the Board's activities and our budget estimate for Fiscal Year 1981. I will be glad to answer any of your questions.

## APPENDIX A

MAJOR RULES, REGULATIONS AND COST ACCOUNTING STANDARDS  
 PROMULGATED BY THE COST ACCOUNTING STANDARDS BOARD  
 AS OF DECEMBER 31, 1979

DESCRIPTION	EFFECTIVE DATE
1. Contract Coverage	July 1, 1972
2. Minimum amount for covered contracts increased from \$100,000 to \$500,000	January 1, 1975
3. Criteria for Materiality	October 4, 1977
4. Exemption of Small Business and Modified Coverage for Certain Classes of Business Units	March 10, 1978
5. Definition of "Cost Accounting Practice" and "Change in a Cost Accounting Practice"	March 10, 1978
6. Exemption for Educational Institutions	August 1, 1978
7. Exemption for Foreign Governments and Contractors	November 3, 1978
8. Disclosure Statement	July 1, 1972
9. Disclosure Statement - Lowering floor for filing to new awards of \$10 million	April 1, 1974
10. Standard 401 - Consistency in Estimating, Accumulating and Reporting Costs	July 1, 1972
11. Interpretation No. 1 to Standard 401	July 1, 1972
12. Standard 402 - Consistency in Allocating Costs Incurred for the Same Purpose	July 1, 1972
13. Interpretation No. 1 to Standard 402	July 1, 1972
14. Standard 403 - Allocation of Home Office Expenses to Segments	July 1, 1973
15. Standard 404 - Capitalization of Tangible Assets	July 1, 1973
16. Standard 405 - Accounting for Unallowable Costs	April 1, 1974
17. Standard 406 - Cost Accounting Period	July 1, 1974

DESCRIPTION	EFFECTIVE DATE
18. Standard 407 - Use of Standard Costs for Direct Material and Direct Labor	October 1, 1974
19. Standard 408 - Accounting for Costs of Compensated Personal Absence	July 1, 1975
20. Standard 409 - Depreciation of Tangible Capital Assets	July 1, 1975
21. Standard 410 - Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives	October 1, 1976
22. Standard 411 - Accounting for Acquisition Costs of Material	January 1, 1976
23. Standard 412 - Composition and Measurement of Pension Cost	January 1, 1976
24. Standard 413 - Adjustment and Allocation of Pension Cost	March 10, 1978
25. Standard 414 - Cost of Money as an Element of the Cost of Facilities Capital	October 1, 1976
26. Standard 415 - Accounting for the Costs of Deferred Compensation	July 10, 1977
27. Standard 416 - Accounting for Insurance Costs	July 10, 1979
28. Standard 420 - Accounting for Independent Research and Development and Bid and Proposal Costs	March 15, 1980

PROJECTS IN PROCESS

A number of research projects, several of which may result in Cost Accounting Standards, are in various stages of completion. They are described below.

Allocation of Indirect Costs

One of the Board's major projects has been the continuing research to develop a series of Cost Accounting Standards related to the allocation of indirect costs. In March 1978 the Board had published a proposed series of five such Standards. Many interested parties submitted comments and suggestions. In 1979 the Board concluded that the issues being dealt with could be covered in three, rather than five, Standards. The proposals were revised and the three new proposed Standards were published in July 1979 in the FEDERAL REGISTER with a request for comments by interested parties. The three proposed Standards are Cost Accounting Standard (CAS) 417, Distinguishing Between Direct and Indirect Costs; CAS 418, Allocation of Indirect Cost Pools; and CAS 419, Allocation of Overhead Costs of Productive Functions and Activities. Comments are being analyzed with a view towards promulgation before the end of this Fiscal Year.

Cost of Money as an Element of the  
Cost of Assets Under Construction

The project examines the merits of extending the cost of money concept enunciated in Cost Accounting Standard 414 to assets under

construction. A similar project dealing with capitalization of interest has resulted in the Financial Accounting Standards Board issuing Statement No. 34 on this subject. The Cost Accounting Standards Board has published a proposed Standard dealing with this subject.

#### Capitalization Criterion

Cost Accounting Standard 404, issued in 1973, requires that a contractor have a written capitalization policy. The policy must provide for capitalization of assets which cost over \$500. Prices generally have gone up since 1973 and the Board believes the Standard should be revised to allow a higher cost criterion. On the basis of a survey of current capitalization practices of business units which are not subject to Cost Accounting Standard 404, the Board has recently published for comment a proposed amendment raising the capital asset cost criterion to \$1000.

#### Gains from Disposition of Capitalized Assets

This project is to examine the need for amendment to Cost Accounting Standard 409, "Depreciation of Tangible Capital Assets," regarding the treatment of gains from disposition of fixed assets. Cost Accounting Standard 409 limits Government sharing in gains to the amount of depreciation previously charged. The Board established the limitation because it recognized that gains in excess of depreciation taken resulted from asset value changes and not errors in depreciation estimates.

Cost Accounting Standard 414, "Cost of Money as an Element of the Cost of Facilities Capital," was established to reimburse contractors for the "real" cost of carrying assets as well as an amount for expected changes in the purchasing power of amounts invested in assets. Since the promulgation of Cost Accounting Standard 414, the Board is reevaluating the appropriateness of the limitation as to recognition of gains from the disposition of fixed assets.

#### Selling and Marketing Costs

Selling and marketing costs are a significant element of the cost of a contractor's operations. They have been the source of many controversies and disputes as to the definition of the costs and how such costs are allocated among Government and commercial contracts.

#### Product Development Costs

In the research performed on Standard 420 dealing with IR&D and B&P costs, the accounting treatment for product development costs surfaced as a potential problem. Most commentators said that the cost of product development should be considered as a separate cost to be accounted for under criteria different from those governing IR&D. A Standard on this subject could set forth criteria for the accounting composition of product development costs and could specify criteria to be used in allocating these costs to covered contracts in future periods.

### Joint Product Costs

There is no single cost accounting method of allocating costs to different products that are produced by the same process, commonly called joint products. An example of the problem is how to allocate the cost of a barrel of crude oil to the various products of a refinery. The Department of Defense (DOD) is a major customer for joint products such as petroleum. DOD attempts to purchase petroleum products on a competitive basis but, in times of shortages, suppliers may not offer sufficient quantities to meet DOD needs. If there are no competitive quotations or suitable market prices, contracts for fuel supplies must be negotiated on the basis of cost and pricing data. In these circumstances it may become necessary to base contract prices on costs. In the absence of a Standard on allocation of joint product costs, it would be difficult if not impossible to reach agreement on joint product costs allocable to a particular contract. Comments on issues are now being reviewed and evaluated.

### Standards in Operation

The Board has established a continuing project to review the effects of Standards which have been promulgated. We have met with representatives of both Government and contractors to explore their experiences under Standards. These reviews should disclose any troublesome areas which may warrant study to determine if the Standards can be improved. This may result in amendments, interpretations, new projects or other actions which will further hone the Cost Accounting Standards, Disclosure Statement and their related rules and regulations.

### Modification of Contract Regulations

In June 1979 the Board proposed a comprehensive revision to the regulations which have been published in Parts 331, 332 and 351 of the Board's regulations. The revision was designed to increase clarity, to remove obsolete material, and to achieve greater consistency of language. It also dealt with a number of suggestions affecting the treatment of increased costs paid by the Government, especially with regard to firm-fixed-price contracts. In response to comments to the June proposal the Board has made substantial revisions and republished the sections for further comment.